## Introduction

### Homeowners Multi-Peril Insurance

Fire insurance on real property has been commonplace in the United States since the nineteenth century. The 1950's saw the introduction of the homeowners multi-peril insurance policy which provided a more comprehensive coverage for damage from fire and additional perils as well as coverage for personal liability arising from use of the real property. These homeowner multi-peril insurance policies became the standard by the 1960's with Insurance Services Office, Inc. (ISO), an industry rating and statistical organization, as the lead sponsor of the standard homeowners insurance policies since that time.[2]

### FAIR Plans

In the 1960's, there were periods of civil unrest, in the United States resulting in extensive property damage (not to mention loss of life) in a number of large metropolitan areas across the United States. This led to a significant change in the insurance and reinsurance markets as it related to the protection of urban property. A national advisory panel on the nation's cities advised the President of the United States that fair access to property insurance was a prerequisite for revitalization of urban America. Following the recommendation of the advisory panel, Congress enacted the Urban Property and Reinsurance Act of 1968. This Act authorized the establishment of "FAIR (Fair Access to Insurance Requirements) Plans" along with federal riot reinsurance to insurers.

Massachusetts followed this federal legislation with Chapter 731 of the Acts of 1968 which established the Massachusetts FAIR Plan formally known as the Massachusetts Property Insurance Underwriting Association (MPIUA). As originally formed, the Commissioner determined that the MPIUA would operate in "urban areas" [3] set to include one county and a number of Massachusetts cities.[4] The MPIUA was established to offer coverage on both a personal and commercial lines basis. On the personal lines side, it was established to offer a standard fire insurance policy, insurance against direct loss from the perils of vandalism and malicious mischief, along with extended coverage to homeowners in these urban areas of the commonwealth. The MPIUA operates similar to an insurance company in that it inspects property, collects premium, issues its own policies, and adjusts its own claims.

In 1970, the Commissioner of Insurance promulgated 211 CMR 5.00 (FAIR Plan) that broadened the definition of "urban area" to include the entire Commonwealth of Massachusetts. It also established that the commission rate to brokers placing business in the MPIUA would be 12% of the premium charged to the insured.[5] This was followed in

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[2] General revisions of these homeowners policies have historically been filed by ISO on an intermittent basis, usually once every five to ten years.

[3] Chapter 731 of the Acts of 1968 defined "urban area" as "any city or town, or streets or sections thereof, in the commonwealth so designated by the commissioner after appropriate hearing." This designation was subsequently accomplished through regulation, 211 CMR 5.00.

[4] The County of Suffolk and the cities of Brockton, Cambridge, Fall River, Haverhill, Lawrence, Lowell, Lynn, New Bedford, Somerville, Springfield and Worcester.

[5] The 12% commission rate has remained constant since that time.

1975 by the promulgation of 211 CMR 21.00 (Extension of the FAIR Plan). This regulation broadened the personal lines coverage offered by the MPIUA from the standard fire insurance policy and extended coverage to the homeowners multi-peril insurance policy. In addition, it required that premium rates charged by the MPIUA to homeowners be tied to the published manual rates of the ISO for standard homeowners risks.[6] Both regulations were found to be inconsistent with Chapter 93 of the Acts of 1996 and were subsequently repealed.

**Studies of Urban Insurance Availability (Redlining)**

Studying a lack of availability in urban areas, examined "redlining" or unfair discrimination against a risk solely due to the geographic location and/or the racial or ethnic characteristics of the insured. "Redlining" has been a controversial issue in property insurance since at least the 1960's and remains so to this day. Charges of redlining have been raised from time-to-time against specific property insurers and the property insurance industry as a whole over the years.

In 1993-95 the National Association of Insurance Commissioners (NAIC)[7] undertook several studies on the issues of availability and affordability of urban insurance in the personal automobile and homeowners insurance markets.[8]The results of the NAIC studies were not conclusive regarding the contentions regarding homeowners insurers redlining in urban areas. However, these studies did point out that there were insurance availability problems in many urban areas. A number of different causes were proposed to affect lack of availability, including underwriting practices, lack of producers in urban areas, rate inadequacy, and carrier misconceptions relative to urban risks no exact causes were pinpointed. It was found, however, that nationally premiums were found to be generally higher in urban areas, as were the loss costs (cost of claims) associated with business in those areas.

In 1995, following the release of the NAIC studies, the Massachusetts Division of Insurance (DOI) through its Special Investigative Unit (SIU) conducted an examination of eight insurers who were major writers of coverage in the Massachusetts homeowners insurance market and representative of the homeowners market as a whole.[9] The SIU examination focused on the marketing and underwriting practices of these insurers in the Boston area. The purpose of the examination was to determine whether any of the eight insurers were engaged in illegal discriminatory underwriting in Boston or any of its

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[6] The ISO rates were based on premium and loss data from all insurance companies that reported their premium and loss data to ISO as their statistical agent. These insurers at that time collectively wrote more than 70% of the homeowners insurance market in Massachusetts.

[7] This association of state insurance commissioners was formed for the purposes of gathering and exchanging information relative to insurance as well as the development of uniformity and consistency of individual state regulation through model laws and regulations.

[8] *A Preliminary Analysis of Urban Insurance Markets*, Robert W. Klein, 1994. *Urban Insurance Problems And Solutions: Interim Report*, National Association of Insurance Commissioners Insurance Availability and Affordability (EX3) Task Force, 1994. *The Impact of Loss Costs on Urban Homeowners Insurance Markets*, Robert W. Klein, 1995.

[9] *Report of Examination of Homeowner Insurance Availability in The Metropolitan Boston Area*, Massachusetts Division of Insurance, November 1995.

neighborhoods. This examination did not reveal any illegal discrimination by these insurers.

While the NAIC studies were not definitive, they did help focus attention on the need for insurers to reassess their approach to urban markets. In Massachusetts this resulted in at least two small changes. First, a brokerage system[10] was designed to help insurers find potential customers who met their underwriting criteria. Second, a cooperative effort between the Massachusetts Affordable Housing Alliance (MAHA) and several insurers was undertaken to encourage risk management training for insureds in urban areas, with discounted premiums as a reward for completion of the training.

**Chapter 93 of The Acts of 1996**

A consensus for reform in the Massachusetts homeowners insurance market was building during and following the NAIC studies and the subsequent DOI examination. All the participants involved in the market, including insurers, insurance agents, consumers, legislators, and regulators, realized that something had to be done to address the availability of homeowners insurance in urban and coastal areas in the voluntary market[11].

All segments of the market provided input to the proposed legislation that was intended to resolve the availability of both urban and coastal homeowners insurance. In order for this legislation to be successful in alleviating the voluntary market availability problems, it needed to address monetary incentives for insurers to write urban and coastal property in the voluntary market, changes in the way that FAIR Plan (MPIUA) rates were determined, and regular reporting so that analysis of comprehensive homeowners insurance data on both an individual company and industry basis could be reviewed.

On May 20, 1996, Chapter 93 of the Acts of 1996, "An Act Relative to Insurance Redlining", was signed into law by Governor Weld and took effect immediately.[12] Among the major points of this legislation, it provided for the following changes:

1. Provided MPIUA assessment credits in 1997-98 for insurers writing voluntary business in territories where the MPIUA had high market penetration.

2. Required MPIUA to provide assessment credits starting January 1, 1999 for insurers writing voluntary business in zip codes where the MPIUA had high market penetration.

> *[The following represent 2004 approved MPIUA's calendar year credit eligible zip codes along with their respective weights:*
>
> | *Zip Code* | *Town* | *Weight* |
> |---|---|---|
> | *02119* | *(BOSTON)* | *1.0* |

[10] This market assistance plan (MAP) was required by Chapter 93 of the Acts of 1996.

[11] The voluntary market is a group of insurers who elect to write insurance in a competitive environment retaining the right to accept and reject business submitted. The voluntary market does not include Excess or Surplus Lines.

[12] Chapter 93 of the Acts of 1996 had an emergency preamble that made the statute effective on enactment.

| | | |
|---|---|---|
| *02121* | *(BOSTON)* | *1.0* |
| *02047* | *(HUMAROCK)* | *1.0* |
| *02125* | *(BOSTON)* | *.90* |
| *02128* | *(BOSTON)* | *.90* |
| *02150* | *(CHELSEA)* | *.80* |
| *01841* | *(LAWRENCE)* | *.80* |
| *02124* | *(BOSTON)* | *.70* |
| *02020* | *(BRANT ROCK)* | *.70* |
| *02713* | *(CUTTYHUNK)* | *.70* |
| *02126* | *(MATTAPAN)* | *.70* |
| *02055* | *(MINOT)* | *.70* |
| *02065* | *(OCEAN BLUFF)* | *.70* |
| *02045* | *(HULL)* | *.70* |
| *02122* | *(BOSTON)* | *.60]* |

3. Provided MPIUA assessment credits for insurers writing voluntary business in coastal territories where more than 60% of the territory business had previously been written in the MPIUA ("take-out credits").

4. Required MPIUA to provide take-out credits starting January 1, 1999 for insurers writing voluntary business in coastal zip codes where the MPIUA had a greater than 60% market penetration.

*[No zip codes were eligible for take out credit for calendar year 2004.]*

5. Tied MPIUA rate changes to rate changes in the voluntary market[13].

**MPIUA Rate Changes Since 1996 Reform Law**

| Effective Date | Overall Rate Change |
|---|---|
| 12/31/96 | +5.30% |
| 12/31/97 | +2.23% |
| 12/31/98 | +0.92% |
| 12/31/99 | +0.13% |
| 12/31/00 | -0.51% |
| 12/31/01 | -0.17% |
| 12/31/02 | +1.92% |
| 12/31/03 | +2.80% |
| 12/31/04 | +3.20% |

*[MPIUA submitted its ninth homeowners insurance rate filing under this law on September 9, 2004. A public hearing on this proposal was held on November 24, 2004. The parties to this hearing (MPIUA, State Rating Bureau, and Attorney General) reached a stipulated agreement with an overall increase of +3.20%*

[13] Chapter 436 of the Acts of 2004 (An Act Relative to the Joint Underwriting Association) unties the rate with respect to the effects of predicted hurricane losses and the cost of catastrophe reinsurance.

*effective December 31, 2004. The Commissioner of Insurance approved the stipulation on November 30, 2004.]*

6. Provided for the top twenty-five insurers and the MPIUA to annually provide detailed cancellation and non-renewal information by zip code for homeowners insurance.

*[This is the tenth consecutive year this type of data has been provided. (See Appendix A)]*

7. Provided for all statistical agent's for homeowners insurance in Massachusetts to submit detailed premium and loss data by territory by form, aggregate insurer premium and loss data by cause of loss by territory by form and by designated zip code by form on an individual company basis.[14]

8. Provided that the Commissioner of Insurance report annually on the state of the Massachusetts homeowners insurance market after substantial analysis of the data submitted in (6) and (7). (Note: "homeowners insurance" has several forms, but the general touchstone is that the insured is the occupant. Real and personal property may be covered as well as personal liability.)

*[This report is the tenth such annual report.]*

9. Authorized alternative loss settlement practices subject to the use of disclosure forms designed by the Commissioner.

*[The Division in 1998 placed on file ISO Actual Cash Value/Functional Replacement Cost loss settlement options for homeowners and dwelling fire insurance policies. These options became effective March 1, 1999 and are available on forms 02 & 03.]*

10. Required the MPIUA to offer an installment plan and provide coverage for scheduled personal property.

*[MPIUA implemented its Premium Installment Payment Program effective October 15, 1997. The program requires a 25% down payment with three equal installment payments.*

*MPIUA Scheduled Personal Property Coverage was made available effective September 1, 1997. MPIUA's program and rates for this coverage are consistent with and similar to the programs and rates utilized by insurers in the Massachusetts voluntary market.]*

11. Required the MPIUA to develop a market assistance plan (MAP) to assist applicants to obtain homeowners insurance in the voluntary market.

[14] The first data submission provided in 1996 was exclusively on a territorial basis. All subsequent data submissions have been required to include certain data on a zip code basis.

*[MPIUA implemented its initial Massachusetts Market Assistance Plan (MA-MAP) effective October 15, 1997. A review of MA-MAP statistics for the first two years of operation show that more than 90% of insureds whose policies were referred to the MA-MAP and were offered policies in the voluntary market declined such offers.*[15] *As a result the initial MA-MAP was revised effective July 1, 1999, so that every qualifying MPIUA homeowners insured*[16] *is given the option of participating in the MA-MAP. At present nine (9) insurers are participating in MA-MAP. The following revisions to MA-MAP were approved by the Commissioner effective July 1, 1999:*

*1. All qualifying new business and renewal applications for coverage with MPIUA will be sent to participating insurers on the request of the applicant; and*
*2. Applicants with two or more losses during the prior 24 months will not be eligible. Additionally, applicants against whom a dog bite claim, not involving trespass, has been filed are not eligible.*

*General principles of the MA-MAP also include a 15% commission level to participating broker/agents and the provision to each participating insurer of a quarterly list of FAIR Plan properties that have been "loss free" for five years or more.]*

**Annual Reports**

The Commissioner issued her first annual report, *Report on the Current State of the Massachusetts Homeowners Insurance Market Pursuant to the Authority and Direction of Chapter 93 of the Acts of* 1996 in October 1996 reviewing Massachusetts homeowners insurance data for the calendar years 1994-1995. The statistical agents were required to provide premium and loss experience by individual insurance company by standard ISO rating territories for all companies that had written homeowners insurance business in 1994 and 1995. The top twenty-five insurers were required to provide, by designated zip code, the number of policies in force, the number of cancellations and the number of non-renewals for calendar years 1994 and 1995.

**Tenth Annual Report**

This year's report reviews Massachusetts homeowners insurance data for calendar year 2004. The statistical agents were required to provide for all reporting insurers voluntary aggregate 2002, 2003 and 2004 written premium data by all Massachusetts zip codes and by ISO Massachusetts homeowners insurance territories. ISO, as the current statistical agent for the FAIR Plan, provides corresponding data for the FAIR Plan. The statistical agents were also required to provide premium and loss experience for each of their reporting companies writing in Massachusetts in 2004 by individual insurance company by standard ISO rating territories, similar data by designated zip codes for the top twenty-five insurers by 2004 written premium, and aggregate 2004 data by cause of loss by territory by form for all reporting insurers and separately for the FAIR Plan. The top

[15] *1999 Report on the Current State of The Homeowners Insurance Market in The Commonwealth*, Exhibit 21, page 2.
[16] Under the original MA-MAP every qualifying new business owners form applicant was automatically submitted to the MA-MAP.

twenty-five insurers were required to provide by designated zip code the number of policies in force, the number of cancellations, and the number of non-renewals for calendar year 2004.

Despite the Commissioner's efforts to check data for accuracy, she is ultimately dependent upon the rating organizations' and companies' accuracy in providing complete and accurate data.

## Analysis of Premium and Loss Experience

### 2004 Loss Ratio Experience

Loss ratio (incurred losses divided by earned premium) is a generally accepted measure of the underwriting success or failure of property insurance. The 2004 overall loss ratio inclusive of loss adjustment expense for the total Massachusetts homeowners insurance market based upon the submitted loss data was 55.2%. This loss ratio is indicative of a good year from an underwriting perspective.[17]

The corresponding loss ratios by year include:

| Year | Loss Ratio |
|---|---|
| 1994 | 67.9% |
| 1995 | 48.4% |
| 1996 | 87.2% |
| 1997 | 49.6% |
| 1998 | 45.8% |
| 1999 | 46.9% |
| 2000 | 55.1% |
| 2001 | 56.6% |
| 2002 | 51.1% |
| 2003 | 59.4% |
| 2004 | 55.2% |

These loss ratios indicate that each year except for 1996 was considered to be a good year from an underwriting perspective, confirming the general principle that success or failure of homeowners insurance in an overall market sense is significantly dependent upon the weather (see Exhibit 16) and catastrophic events. In the year 2004 there was a further relative decrease in Massachusetts in terms of snowfall and an increase in catastrophes. The non-weather related causes of loss generate fewer sharp increases in losses[18] and claims from year-to-year, whereas the weather-related causes of loss often show more significant fluctuations from year-to-year (Exhibit 12).

The total market overall loss ratio for 2004 of 55.2% can be further broken down into 2004 loss ratios by homeowners type of policy form. This breakdown is as follows:

[17] Homeowners insurance loss ratios in the 60% or lower range are considered to be good underwriting results.

[18] Fire losses are an exception to this in so far as fires involving multiple dwellings can significantly impact losses for the year.

| Form | Loss Ratio |
|---|---|
| Condominium | .480 |
| Dwelling | .564 |
| Renter | .217 |
| | |
| All | .552 |

From a review of the voluntary market and MPIUA (FAIR Plan) portions of the overall 2004 loss ratio results (Exhibits 7 & 8) it appears that the voluntary market carriers had more favorable experience than did the FAIR Plan. The 2004 loss ratios for the voluntary market and FAIR Plan were 53.5% and 72.8% respectively. The loss ratio for the FAIR Plan was approximately 19.3% percentage points higher than the loss ratio for the voluntary market carriers. This is not surprising or unexpected given the adverse selection and subsidies in the FAIR Plan rates resulting from statutorily required rate setting practices. This demonstrates that the FAIR Plan's 1998 underwriting result (25.2% loss ratio) was a deviation from the norm.

A closer look at the loss ratios for the FAIR Plan owner forms by territory[19] (Exhibits 7 & 8) indicates the following:

Massachusetts Homeowners Insurance Loss Ratios
Owners Forms

| Territory | Territory Description | FAIR Plan Mkt. Share (2002-2004) | 2004 Vol. Market | 2004 FAIR Plan |
|---|---|---|---|---|
| 2 | Boston - District A | 42.9% | 51.9% | 83.0% |
| 3 | Boston - District B | 4.9% | 42.3% | 59.5% |
| 4 | Boston - District C | 67.7% | 51.4% | 81.9% |
| 5 | Suffolk (except Boston) | 26.9% | 54.0% | 86.1% |
| 11 | Boston – (except Districts A, B & C) | 15.3% | 35.7% | 72.3% |
| 12 | Brookline | 2.1% | 53.2% | 284.9% |
| 30 | Quincy | 10.0% | 55.6% | 45.4% |
| 31 | Norfolk (except Brookline & Quincy) | 2.6% | 52.4% | 84.3% |

[19] The owner form, compared to the condominium form and tenant form, represents the largest market share in each territory.

Massachusetts Homeowners Insurance Loss Ratios
Owners Forms

| Territory | Territory Description | FAIR Plan Mkt. Share (2002-2004) | 2004 Vol. Market | 2004 FAIR Plan |
|---|---|---|---|---|
| 32 | Fall River | 13.1% | 57.9% | 56.3% |
| 33 | New Bedford | 20.7% | 42.3% | 83.8% |
| 34 | Bristol (except Fall River & New Bedford) | 4.5% | 57.2% | 44.2% |
| 35 | Brockton | 20.7% | 60.2% | 83.5% |
| 36 | Plymouth (except Brockton) | 8.5% | 52.3% | 86.9% |
| 37 | Barnstable, Dukes and Nantucket | 12.8% | 60.5% | 62.5% |
| 38 | Lawrence | 43.3% | 31.1% | 53.2% |
| 39 | Lynn | 22.1% | 37.9% | 66.7% |
| 40 | Essex (except Lawrence & Lynn) | 3.9% | 54.6% | 83.8% |
| 41 | Cambridge & Somerville | 6.1% | 63.5% | 35.2% |
| 42 | Lowell | 12.5% | 64.4% | 228.6% |
| 43 | Newton | 1.9% | 72.2% | 63.5% |
| 44 | Middlesex Remainder | 2.3% | 56.5% | 46.5% |
| 45 | City of Worcester | 11.8% | 49.3% | 47.5% |
| 46 | Worcester (except City of Worcester) | 3.1% | 48.4% | 63.4% |
| 47 | Springfield | 10.5% | 51.2% | 102.7% |
| 48 | Chicopee & Holyoke | 5.1% | 53.2% | 39.8% |
| 49 | Hampshire & Remainder of Hampden | 2.9% | 53.3% | 92.1% |
| 50 | Berkshire & Franklin | 3.7% | 64.9% | 81.2% |
| Statewide | | 7.6% | 54.7% | 73.5% |

According to reported information, the voluntary market carriers experience good results and the FAIR Plan experienced poor results. FAIR Plan results have slightly moderated across most territories shown above compared to the 2002 and 2003 loss ratio results, with loss ratios for this form of 101.8% and 84.5% respectively. As demonstrated in Exhibit 12, total market water damage & freezing claims decreased 12.5%. There was also a decrease in Boston's 2004 annual snowfall, a proxy for Massachusetts snowfall, as shown in Exhibit 16, page 1. The voluntary market results shown above give mixed results with more territories higher and fewer territories lower than the 2002 results. However, the statewide voluntary loss ratio for 2004 is the second lowest for the 2001-04 period (54.7% vs. 57.1%, 48.9% and 59.1%). This also shows that the overall voluntary market results are generally more consistent from year to year than the FAIR Plan results

(73.5% vs. 76.9%, 101.8% and 84.5%) over the same period. However, this is not surprising given that FAIR Plan loss ratio data is not as highly credible from a statistical standpoint.[20]

The number of FAIR Plan earned house-years by territory is such that the loss ratio experience can be expected to experience significant random fluctuations from year to year within individual territories. One example of this is territory 41 (Cambridge/Somerville). The voluntary market in 2004 had 38,593 total earned exposures that generated a total of 1,512 incurred claims. The FAIR Plan had 2,478 total earned exposures in the same territory that generated a total of 113 claims. It is not surprising in this territory that the FAIR Plan loss ratio dropped from 82.0% in 2003 to 34.1% in 2004 given this limited exposure and the resulting low credibility of the experience. Care should be exercised so as to not place too much weight upon any FAIR Plan individual territory loss ratio result for any one year when the loss ratio is based upon a relatively small number of house-years of insurance.

As expected a comparison of 2003 and 2004 loss ratio experience by territory reveals more variability in the FAIR Plan than the voluntary market.

| Voluntary Market Loss Ratios-All Forms | | | FAIR Plan Loss Ratios-All Forms | | | |
|---|---|---|---|---|---|---|
| Territory | 2003 | 2004 | Territory | 2003 | 2004 | Territory Description |
| 2 | 34.7% | 46.2% | 2 | 48.0% | 81.4% | Boston – District A |
| 3 | 108.9% | 52.7% | 3 | 41.5% | 54.5% | Boston – District B |
| 4 | 26.5% | 47.0% | 4 | 77.5% | 81.5% | Boston – District C |
| 5 | 36.9% | 52.1% | 5 | 94.4% | 85.3% | Suffolk (except Boston) |
| 11 | 37.8% | 35.9% | 11 | 88.8% | 70.8% | Boston – (except Districts A, B & C) |
| 12 | 35.1% | 53.4% | 12 | 7.5% | 234.6% | Brookline |
| 30 | 44.4% | 53.9% | 30 | 66.7% | 45.7% | Quincy |
| 31 | 51.6% | 51.4% | 31 | 111.7% | 84.4% | Norfolk (except Brookline & Quincy) |
| 32 | 47.0% | 55.8% | 32 | 39.3% | 62.2% | Fall River |
| 33 | 48.2% | 41.6% | 33 | 54.5% | 82.3% | New Bedford |
| 34 | 50.7% | 56.1% | 34 | 56.1% | 43.8% | Bristol (except Fall River & New Bedford) |
| 35 | 54.8% | 59.5% | 35 | 91.7% | 83.1% | Brockton |
| 36 | 67.2% | 52.0% | 36 | 119.7% | 86.8% | Plymouth (except Brockton) |
| 37 | 64.7% | 59.8% | 37 | 78.2% | 62.1% | Barnstable, Dukes and Nantucket |
| 38 | 38.9% | 31.2% | 38 | 106.4% | 52.8% | Lawrence |
| 39 | 38.6% | 38.8% | 39 | 43.6% | 66.6% | Lynn |

[20] Exhibits 7 & 8 show the Voluntary Market with approximately 1.75 million written house years and 71,200 claims and the FAIR Plan with approximately 132,500 written house years and 5,000 claims.

| Voluntary Market Loss Ratios-All Forms | | | FAIR Plan Loss Ratios-All Forms | | | |
|---|---|---|---|---|---|---|
| Territory | 2003 | 2004 | Territory | 2003 | 2004 | Territory Description |
| 40 | 58.7% | 53.7% | 40 | 100.1% | 82.8% | Essex (except Lawrence & Lynn) |
| 41 | 42.1% | 57.2% | 41 | 82.0% | 34.1% | Cambridge & Somerville |
| 42 | 44.2% | 63.2% | 42 | 98.0% | 225.7% | Lowell |
| 43 | 70.7% | 70.3% | 43 | 130.6% | 59.9% | Newton |
| 44 | 57.7% | 55.1% | 44 | 92.7% | 46.5% | Middlesex Remainder |
| 45 | 60.0% | 47.9% | 45 | 82.2% | 46.9% | City of Worcester |
| 46 | 60.8% | 47.8% | 46 | 108.4% | 62.6% | Worcester (except City of Worcester) |
| 47 | 70.6% | 51.4% | 47 | 101.5% | 102.4% | Springfield |
| 48 | 66.3% | 50.9% | 48 | 21.0% | 39.0% | Chicopee & Holyoke |
| 49 | 63.8% | 51.8% | 49 | 108.2% | 90.1% | Hampshire & Remainder of Hampden |
| 50 | 70.3% | 63.1% | 50 | 86.1% | 80.4% | Berkshire & Franklin |
| Total | 57.5% | 53.5% | Total | 83.9% | 72.8% | Statewide |

**2004 Overall Cause of Loss Analysis**

The overall causes of loss totals for the 2004 Massachusetts homeowners insurance market are shown at the end of Exhibit 10. The 2004 cause of loss claim counts as a percentage of total claims are similar to the 2003 cause of loss claim distribution, with only minor differences that range from -1.5% to 2.4% in percentage of total claims. The only exception was in the *all other claims* category which has a difference in the percentage of total claims of -4.1% that is somewhat larger.

*Water damage and freezing* claims in 2003 and 2004 as a percentage of total claim counts at 44.6% and 46.8% respectively were more similar than in past years. The change in these claim counts as a percentage of the total is somewhat surprising given that the 2003 Boston snowfall was 77.7 inches versus 29.0 inches for 2004 (Exhibit 16, page 1). While the Boston snowfall is used as a proxy for the statewide snowfall, the correlation is not perfect. Other factors that impact this type of claim are the number of snowstorms and the corresponding number of freeze/melt cycles. Fire, lightning, and removal claims as a percentage of total homeowners insurance claims increased from 9.3% in 2003 to 11.7% in 2004.

It is also noteworthy that in comparing the 2003 and the 2004 claims by cause of loss that there was a decrease in the percentage of *wind and hail* claims from 9.2% in 2003 to 7.6% in 2004 and a moderate increase in the percentage of *theft* claims from 10.3% in 2003 to 10.5% in 2004. In 2003 there was one catastrophic event compared to two in

2004. The catastrophic events[21] that impacted Massachusetts in both 2003 and 2004 involved *wind and hail* and w*ater damage and freezing.*

The *all other* cause of loss claims as a percentage of total claims decreased, as noted above, from 23.8% in 2003 to 19.7% in 2004. The *all other* cause of loss code is used (a) when the claim doesn't fit one of the other causes of loss, (b) when there is some question as to which cause of loss among several possible causes of loss caused the claim, or (c) when the cause of loss is not known initially. In general, claims initially classified as *all other* are not subsequently reclassified.

The remaining causes of loss, *liability and medpay,* shows a change in the percentage of total claims from 2.8% in 2003 to 3.6% in 2004. This is a change in the percentage of total claims of 0.8%.

It is indicated in Exhibit 12 for the non-weather-related causes of loss that there was either a relatively stable number of claims from year-to-year or small changes in the number of claims. The absolute number of claims for these non-weather-related perils does change in small amounts over time compared to the weather-related causes of loss which has large swings in the absolute number of claims. This reinforces the susceptibility of homeowners insurance results to fluctuations in weather. The number of claims and amount of losses that are not weather-related usually have smaller changes from year-to-year in the absence of unusual happenings. The claims and losses related to the weather-related causes of loss - *wind & hail* and *water damage & freezing* - experience large changes due to severe or catastrophic weather events. The fact that non-weather related causes of loss do not experience large shifts in claims and losses from one year to the next should not be interpreted to mean that non-weather related causes of loss claims and losses can not experience gradual shifts over time.

**Cause of Loss Analysis by Territory[22]**

Cause 1, f*ire, lightning and removal* losses decreased slightly from 33.3% of total statewide losses in 2003 to 33.1% of total statewide losses in 2004.

- Territory 3 (Boston District B) experienced the largest decrease in fire losses from 52.5% in 2003 to 6.5% in 2004.

Other territories experiencing larger decreases in fire losses in 2004 include:

- Territory 43 (Newton) which decreased from 37.6% in 2003 to 16.9% in 2004; and
- Territory 45 (Worcester) which decreased from 39.5% in 2003 to 20.7% in 2004.

Territories with high fire losses relative to the statewide percentage include :

- Territory 42 (Lowell) at 59.5%; and
- Territory 4 (Boston District C) at 59.3%.

[21] Massachusetts catastrophe code numbers were assigned by Property Claims Services, Inc. (PCS), a subsidiary of ISO, Inc. This organization assigns catastrophe code numbers to natural events when insurable losses resulting from a natural event exceed $25 million and at least 2,000 claims.

[22] See Exhibit C for full territory description

The statewide average fire claim cost was approximately $24,063 in 2003 versus $24,547 in 2004. The statewide number of fire claims increased from 8,514 (9.3% of total) in 2003 to 8,926 (11.7% of total) in 2004.

From a closer look at the loss experience demonstrated the following:

- Territory 3 (Exhibit 10) it appears that the number of fire claims in Boston District B increased from 12 claims in 2003 to 19 claims in 2004. At the same time, the average fire claim cost in Boston District B decreased from approximately $226,754 to $10,543.
- Territory 43 (Newton) experienced a decrease in fire claims from 104 in 2003 to 87 in 2004 and its average fire claim cost also decreased from approximately $50,765 to $30,015 over the same period.
- Territory 45 (Worcester) experienced a decrease in fire claims from 215 in 2003 to 130 in 2004. The average fire claim cost for Territory 45 (Worcester) also decreased from approximately $23,477 to $17,158 over the same period.
- Territory 42 (Lowell) experienced an increase in fire claims from 69 in 2003 to 110 in 2004 with its average fire claim cost increased from approximately $30,096 to $52,431 over the same period.
- Territory 4 (Boston District C) experienced a decrease in fire claims from 27 in 2003 to 26 in 2004, however its average fire claim cost increased from approximately $74,970 to $97,060 over the same period.

It is clear that in 2004 the slight statewide decrease in the percentage of fire loss dollars was affected by both claim severity and claim frequency.

Cause 2, *wind & hail* losses decreased from 4.2% of total statewide losses in 2003 to 2.8% of total statewide losses in 2004. The majority of territories experienced a decrease in wind losses as a percentage of total statewide losses.

- Territory 32 (Fall River) experienced the largest decrease in wind losses from 9.0% of total homeowner losses in 2003 to 4.2% of total homeowner losses in 2004.

Some of the other territories that experienced larger decreases in wind losses of total homeowner losses include:

- Territory 48 (Chicopee & Holyoke) with a decrease 6.6% 2003 to 1.9% in 2004;
- Territory 50 (Franklin & Berkshire) with a decrease from 9.7% of total homeowner losses in 2003 to 5.4% in 2004; and
- Territory 42 (Lowell) with a decrease from 5.0% in 2003 to 1.3% in 2004.

Territories which experienced increases in percentage of total losses in this cause of loss include:

- Territory 31 (Norfolk except Brookline & Quincy) which went from 3.4% in 2003 to 3.9% in 2004;
- Territory 3 (Boston District B) which went from .04% in 2003 to .06% in 2004; and
- Territory 45 (Worcester) which went from 3.9% in 2003 to 4.0% in 2004.

The statewide average wind claim cost was approximately $3,105 in 2003 and $3,228 in 2004.

- Territory 44 (Middlesex Remainder) experienced the largest number of claims with a decrease in the number of wind claims from 1,277 in 2003 to 1,012 in 2004. At the same time its average wind claim cost decreased slightly from approximately $3,091 to $3,027.

Cause 3, *water damage & freezing* losses as a percentage of total homeowner losses increased from 36.2% in 2003 to 36.7% in 2004.

The territories which experienced larger increases in losses from this type of claim during this period included Territory 30 (Quincy), Territory 38 (Lawrence) and Territory 33 (New Bedford), in the following ways;

- Territory 30 went from 30.7% of all losses in 2003 to 47.2% of all losses in 2004. Its claim count increased from 370 in 2003 to 449 in 2004, while its average claim cost increased from approximately $4,313 to $7,327 over the same period;
- Territory 38 went from 11.8% of all losses in 2003 to 27.3% of all losses in 2004. Its claim count decreased 149 in 2003 to 148 in 2004, however its average claim cost increased from approximately $3,480 to $5,380 over the same period; and
- Territory 33 went from 17.7% of all losses in 2003 to 31.2% of all losses in 2004. Its claim count increased from 267 in 2003 to 291 in 2004, while its average claim cost also increased from approximately $3,033 to $5,568 over the same period.

Cause 4, *theft*, losses decreased from 3.2% of all losses in 2003 to 2.9% in 2004. The average statewide theft claim cost over the 2003-2004 period went from $2,118 to $2,371, an increase of 11.9%. The statewide number of claims decreased from 9,394 to 8,010, a decrease of 14.7%.

Some of the territories that had larger decreases in the number of claims include Territory 36 (Plymouth except Brockton), Territory 49 (Hampshire & Remainder of Hampden) and Territory 40 (Essex except Lawrence & Lynn), in the following ways:

- Territory 36 saw a decrease in the number of claims from 631 in 2003 to 451 in 2004 or –28.5%;
- Territory 49 saw a decrease in the number of claims from 643 in 2003 to 469 in 2004 or –27.1%;
- Territory 40 saw a decrease in the number of claims from 835 in 2003 to 704 in 2004 or –15.7%;
- Territory 35 (Brockton), on the other hand, saw an increase in the number of claims from 99 in 2003 to 132 in 2004 or 33.3%;
- Territory 30 (Quincy) saw an increase in the number of claims from 103 in 2003 to 125 in 2004 or 21.4%;
- Territory 2 (Boston District A) also saw an increase in the number of claims from 194 in 2003 to 210 in 2004 or 8.2%; and
- Other territories experienced smaller increases or decreases in the number of claims from 2003 to 2004.

Cause 6, *liability & medical payments* losses as a percentage of total losses increased from 7.3% in 2003 to 8.8% in 2004. The total statewide number of liability & medical payment claims increased from 2,518 in 2003 to 2,782 or 10.5%. The corresponding statewide average claim cost increased from $17,811to 20,916 or 17.4% over the same period, in the following ways:

- Territory 3 (Boston District B) increased by 9.2%,
- Territory 34 (Bristol except Fall River & New Bedford) increased by 14.3%, and
- Territory 4 (Boston District C) at 12.1% experienced some of the larger increases in liability and medical payment losses as a percentage of total losses;
- The Territory 3 increase was primarily due to a 370.6% increase ($3,736 to $17,581) in average claim cost as claim counts actually decreased from 20 to 16 over the same period;
- The Territory 34 increase was primarily due to a 94.5% increase ($13,705 to $26,656) in average claim cost as claim counts increased from 151 to 195 over the same period; and
- The Territory 4 increase was primarily due to a 166.2% increase ($27,669 to $73,660) in average claim cost as claim counts remained the same at 7.

Cause 9, *all other* losses remained the same as a percentage of total homeowners insurance losses at 15.7% for both 2003 and 2004. The average statewide all other average claim cost increased from $4,426 in 2003 to $6,911 in 2004. The total number of all other claims decreased from 21,806 (23.8% of total) to 15,051 (19.7% of total). This cause of loss reflects losses where no cause is initially known, several causes may be involved, or a cause of loss that doesn't fall into one of the other causes of loss.

**MPIUA Market Share and Rate Subsidies**

The overall MPIUA market share based upon written premium has increased from 5.9% in calendar year 2002 to 9.6% in calendar year 2004. The MPIUA territorial market share by year based upon calendar year 2002-2004 written premium is shown in Exhibit 17. This exhibit shows relatively stable changes, except territories Territory 37 (Barnstable, Dukes and Nantucket), 38 (Lawrence), 33 (New Bedford) and Territory 36 (Plymouth Remainder), in MPIUA market share from 2002 to 2004. All of the MPIUA market share territories have increased this year from the 0.1% of Territory 41 (Cambridge/Somerville) to the 11.8% of Territory 37 (Barnstable, Dukes and Nantucket) with the exception of Territory 3 (Boston District B) that decreased slightly by 0.2%. Some of the larger MPIUA market share increases of 11.8%, 5.4% and 4.9% were in Territory 37 (Barnstable, Dukes and Nantucket), Territory 33 (New Bedford), and Territory 38 (Lawrence) respectively. The FAIR Plan dwelling forms policy counts for Boston territories and non-Boston territories also increased in raw numbers. Business in the coastal territories[23] as a percentage of FAIR Plan business, on average, appears to have increased both in percentage and raw numbers (as shown in Exhibit 19).

Exhibit 18 is a chart of the annual number of homeowners policies issued by the MPIUA from fiscal years 1995 through 2004. Overall the number of policies increased from 58,179 in 1995 to 135,000 in 2004, an increase of 132%. Policies issued have increased

[23] Coastal territories for purposes of calculation under this section territories 34, 36 & 37 are used.

over each annual period other than 1999 to 2000. The first large increase (9.4%) in MPIUA homeowners policies during this period occurred between fiscal year 1995 and fiscal year 1996. The 1996 fiscal year was the fourth fiscal year following Hurricane Andrew (1992) which caused such extensive damage in the southeastern United States. The 1995/1996 increase was followed by annual increases in the number of MPIUA homeowners policies issued of 6.1% from 1996 to 1997, 2.7% from 1997 to 1998, and 4.1% from 1998 to 1999. The 1.3% decrease from 1999 to 2000 (72,197 to 71,288) represented the first annual decline in policy counts in the 1995-2004 period. An increase of 4.7% occurred from 2000 to 2001, 12.8% from 2001 to 2002 and 18.0% from 2002 to 2003. The 36.0% increase from 2003 to 2004 (99,283 to 135,000) represented the largest increase in the 1995-2004 period.

The large past increases in the number of MPIUA homeowners policies were dominated by the influx of coastal property policies into the MPIUA. This can be seen in Exhibit 19 which presents HO-2 & HO-3 (dwelling forms) policy totals by year by rating territory. Boston territories represented 26.3% of the MPIUA homeowners dwelling form policies as of December 31, 1997. The same Boston territories decreased to 13.3% of the MPIUA policies as of December 31, 2004. Coastal rating territories over the same period increased their share of these MPIUA policies from 22.8% to 36.5%. This represented an increase in the number of coastal territory policies from approximately 11,514 in 1997 to 42,412 in 2004, an increase of 268.4%. Cape Cod & the Islands increased from 4,559 policies in 1997 to 27,223 policies in 2004, an increase of 497.1%. Plymouth County, excluding Brockton, increased from 5,403 policies in 1997 to 10,935 policies in 2004, an increase of 102.4%. Bristol County, excluding Fall River and New Bedford, increased from 1,552 policies in 1997 to 4,254 policies in 2004, an increase of 174.1%. Other areas that had large percentage increases in MPIUA policies over the 1997-2004 period include Territory 49's (Hampden & Hampshire Remainder) 356.5%, Territory 48's (Chicopee & Holyoke) 312.2%, Territory 50's (Franklin & Berkshire) 303.3%, Territory 47's (Springfield) 208.7%, Territory 32's (Fall River) 231.6%, Territory 46's (Worcester Remainder) 183.5%, Territory 31's (Norfolk Remainder) 150.0%, Territory 40's (Essex Remainder) 130.6%, Territory 45's (City of Worcester) 129.9% and Territory 33's (New Bedford) 120.3%. The MPIUA statewide HO-2 & HO-3 counts increased by 129.6% over the same interval. The MPIUA statewide HO-2 & HO-3 policy counts from December 31, 2004 to June 30, 2005 also increased from 116,263 to 128,599 or by 10.6%.

A review of the MPIUA statutory profit or loss from Exhibit 18 shows a homeowners insurance underwriting profit of $3.042 million in fiscal year 2004[24]. The 2004 fiscal year has been the first year for underwriting profit in a number of years. The last underwriting profit prior to 2004 was the $7.7 million posted in fiscal year 1998 followed by an underwriting profit of $0.35 million in fiscal year 1999. This translates into an average underwriting profit per policy of $111 in fiscal year 1998, underwriting profit per policy of $5 in fiscal year 1999 and underwriting profit per policy of $23 in fiscal year 2004. Underwriting losses per policy of $26, $113, $84 and $138 occurred in fiscal years

[24] The MPIUA fiscal year runs from October 1st of one calendar year to September 30th of the following calendar year, *e.g.*, fiscal year 2004 runs from October 1, 2003 to September 30, 2004.

2000, 2001, 2002 and 2003. The average underwriting profit/loss per policy over the fiscal year 1995-2004 period is a loss of $53.

In the 1995-2004 period, underwriting subsidies have ranged from a low of -$111 (surplus) per policy in 1998 to a high of $253 per policy in 1996. The MPIUA rate subsidies have been present in urban area rates for a number of years. Factors in addition to rate subsidies forced coastal insureds to seek coverage in the MPIUA after the voluntary market tightened for these types of risks. These factors included the unavailability of voluntary market insurance due to the cost of reinsurance and restrictions imposed on primary insurers by their reinsurers.

It is possible for rate subsidies in a residual or non-voluntary market to constrict the overall voluntary market. This can occur when the underwriting deficit for the residual market is of such a magnitude that it causes a high cost to be added to each policy written in the voluntary market so that the deficit subsidy amount added to each policy written in the voluntary market converts an otherwise profitable policy written in the voluntary market to a net loss policy[25]. Massachusetts experienced this effect in its workers' compensation and private passenger automobile markets prior to the initiation of legislative reforms[26]. The MPIUA deficit is not now, nor has it been, near that stage since its inception. The MPIUA deficits shown on Exhibit 18 should be measured against a Massachusetts voluntary homeowners insurance market of more than $1 billion in annual written premium.

A review of MPIUA rates relative to rates in the voluntary market (Exhibit 21) shows that MPIUA rates continue to be a bargain in most territories[27]. The MPIUA rates are often among the lowest compared to the top ten insurers by market share[28]. The MPIUA rates appear to be even higher than they really are when the voluntary market underwriting criteria are factored into the comparison. These rates are low despite loss experience that would warrant a significant rate increase to bring rates to the break-even point, but for statutory prohibitions. Furthermore, if the MPIUA reinsured against the risk of hurricanes, the cost of reinsurance may warrant a still higher rate. Thus one of the impediments to reducing the FAIR Plan's market share is the fact that MPIUA rates are more affordable for identical coverage *offered* at higher prices in the voluntary market. This is supported by statistics from the MPIUA Market Assistance Plan (MA-MAP) in Exhibit 20. The most telling statistic in Exhibit 20 is the small number of insureds that even requested to be shopped around in the voluntary market, *i.e.*, less than 300, when the MPIUA is writing approximately 135,000 homeowners policies. One would expect that if coverage under a voluntary market policy were the primary issue for FAIR Plan insureds, then a much higher number of them would check off the box on the FAIR Plan application so that the FAIR Plan would shop their homeowners insurance coverage in

[25] Even if there is no underwriting deficit in a particular year, the cost to voluntary insurers to reinsure their assessment risk may create a deficit.
[26] Chapters 398 and 399 of the Acts of 1991 and Chapter 273 of the Acts of 1988.
[27] This exhibit shows MPIUA rates effective as of 12/31/04.
[28] An insurer's lower rate for a certain classification of risk can be misinterpreted as competitive if the insurer's underwriting criteria result in relatively few offers of voluntary policies to risks in that classification.

the voluntary market. It is clear that price is more important to these insureds, than the issue of which insurer provides coverage.

**Coastal Property**

Hurricane Andrew (1992) was a watershed event in property insurance. Its impact carried far beyond the southeastern United States area that experienced the physical impact of this hurricane. Reinsurers increased general reinsurance rates and catastrophe reinsurance contracts following Andrew, and after the Northridge, California earthquake. Excess capacity in recent years and the passage of time following Andrew and Northridge had led to decreases in reinsurance costs from the high points following Andrew and Northridge. Prior to September 11, 2001, reinsurance costs had started to increase once again due to poor underwriting results. The September 11, 2001 terrorism events created both a financial and psychological price spike due to unavailability of coverage in the reinsurance markets. In addition, scientists and actuaries have developed revised catastrophe models, that have fueled the increase in reinsurance prices. Insurers are still feeling the effects of reported reinsurance price increases of 25% and higher for the same or even less coverage. Additionally, most reinsurers are excluding losses resulting from acts of terrorism. While the terrorism exclusion by reinsurers may not have much direct impact on homeowners insurance, the reinsurance price increases, along with writing restrictions, *e.g.*, restrictions on coastal property or increased cost due to the level of coastal property, will have a direct impact. Finally some reinsurers have limited primary insurers' exposure to catastrophic loss by restricting the amount of coastal property they will reinsure in each insurer's book of business. This has resulted in more costal policies placed in the FAIR Plan.

The aftermath of Hurricane Andrew also saw the introduction of both wind deductibles and mandatory flood insurance requirements imposed by insurers. Many homeowners insurers require all insureds or insureds located in certain coastal territories, such as Territory 37 (Barnstable, Dukes and Nantucket Counties), or insureds within 1,000 or 2,500 feet of the coast to have a minimum wind or hurricane deductible[29] that is either a flat dollar or percentage of dwelling amount basis. The MPIUA, for example, currently requires certain insureds to have a minimum wind percentage deductible of 1% to 5% (of coverage A limit) or a minimum fixed dollar deductible from $0 to $5,000 depending on the property's county, distance from the coast and coverage A limit. In these situations, it is essential that consumers be given clear disclosures as to the coverage they have in the event of wind or hurricane loss. These disclosures should be given to consumers before the consumer has placed coverage with the insurer.

Many homeowners insurers also require coastal insureds who may be susceptible to ocean storm surge to purchase federal flood insurance as an underwriting requirement for homeowners insurance coverage. In this situation, the insured would have coverage and the insurer and the Federal Insurance Administration (FIA) could determine whether the homeowners insurance policy or the flood insurance policy is liable for the losses. In recent years, the FIA has encouraged having one adjuster for both claims to help streamline the claims process for insureds. Insureds who have mortgages owned by the

[29] A wind deductible is a deductible that applies only to losses caused by wind.

Federal National Mortgage Association (Fannie Mae) are required to purchase flood insurance if the property is located in areas susceptible to storm surge or floods.

The federal government is working through the Federal Emergency Management Administration (FEMA) to help assure that properties damaged in natural disasters are rebuilt/repaired to strengthen their ability to sustain, or avoid, the next similar disaster. This means that homeowners policies will need to be able to provide coverage for the risk that rebuilding to the pre-loss condition or even at the pre-loss location might not be allowed. Changes (strengthening) in building codes are being encouraged by FEMA and the Massachusetts Emergency Management Administration (MEMA), (the state agency that works with FEMA on such matters). Both are also engaged in encouraging improvements in structures to help mitigate losses.

One of the problems related to ocean storm surge damage is the question of whether the loss was caused by wind that is a peril covered by the homeowners insurance or by ocean storm surge that is not covered by the homeowners insurance policy. In these cases, if the insureds have not purchased federal flood insurance, then a wind claim is often filed with the potential of a denied claim and no recovery for the loss. If the insured has both homeowners and flood insurance, then the insured will have coverage whether the cause of loss is determined to be wind or ocean storm surge. Hurricane Isabel is a good example of when this problem was an issue.

Prior to Hurricane Andrew, insurers used several decades of wind experience to determine an average excess wind factor to load into their rates. The purpose was to smooth out the effects of a catastrophic event such as a hurricane or tornado and prevented rate shock immediately following the catastrophic event. After Hurricane Andrew, insurers felt that the average excess wind methodology significantly understated the average wind load needed to compensate insurers for the potential catastrophic loss. This has led to the development of hurricane models in order to predict potential hurricane losses. These hurricane models are often proprietary computerized hurricane simulation models that combine multiple disciplines such as wind theory, meteorology, building engineering, historical enforcement of building codes, and financial theory. Hurricane models developed by a relative few modeling firms are used by the majority of homeowners insurers. These models have been refined and recalibrated in recent years.

**Cancellation & Non-Renewal Data**

The top twenty-five homeowners insurers[30] by Massachusetts market share are required[31] under Chapter 175, §4B to file a listing of policies in force, cancellations, and non-renewals listed by those zip codes designated by the Commissioner on a calendar year basis for policies written on or after January 1, 1994. In addition, insurers are requested to provide the number of cancellations and non-renewals initiated by the insurer and insurer initiated non-renewals because of claim frequency.

[30] Exhibit 22 provides a list of insurers and each of their individual insurance companies that were writing homeowners insurance in Massachusetts in 2004. Some of these insurers are better known by the names of their individual insurance companies.

[31] Cancellation and non-renewal data is not currently captured by any of the homeowners statistical plans.

This year (as with last year's report) any questionable individual company data was presented to the companies to verify that the data they submitted to the Commissioner was in fact their correct data.

This year's submissions included data for calendar year 2004. This requirement is detailed in Exhibit 2. The cancellation & non-renewal listings, unlike company-specific premium and loss data, are to be considered public records under this statute. The individual insurer listings and the MPIUA listing are detailed in Appendix A. The industry aggregate (top twenty-five insurers) listing of cancellations and non-renewals by designated zip codes is shown in Appendix B.

This year's report includes a summary comparison of urban and coastal writings by insurer (see Exhibit 23). This exhibit compares the number of individual insurer 2004 urban and coastal policies-in-force in the selected zip codes relative to each percent of statewide voluntary market share. This is one way to make an insurer-by-insurer comparison of the number of urban and coastal writings in the selected zip code areas.

In Exhibit 23, it is noted that only a couple of insurers are ranked near the top of the list who write policies in urban and coastal zip code areas by percent of voluntary market share. They are Providence Group ($4^{th}$ & $4^{th}$) and Hingham Mutual Group ($7^{th}$ & $2^{nd}$) in urban and coastal areas respectively. Other insurers ranked near the top in one of the two categories. In the urban category Preferred Mutual Insurance Company ($1^{st}$), Union Mut-VT ($2^{nd}$), Vermont Mutual Group ($3^{rd}$), represented some of the top urban writers by policies as a percentage of voluntary market share. In the coastal category Barnstable Group ($1^{st}$), White Mountains Group (formerly OneBeacon Insurance Group) ($3^{rd}$), National Grange Mutual Insurance Group ($5^{th}$) ranked near the top. However, urban and coastal property continues to be a problem for some insurers. Barnstable Group, new to the top twenty-five group list for 2004, ($25^{th}$), Chubb & Son, Inc. ($24^{th}$), and Allianz Group ($23^{rd}$) had the lowest number of 2004 urban policies-in-force per percent of voluntary market share. Commerce Group, Inc. ($25^{th}$), Andover Group ($24^{th}$), and Preferred Mutual ($23^{rd}$) had the lowest number of 2004 coastal policies-in-force per voluntary market share.

One insurer, the Barnstable Group, was added to the list and one insurer, Royal & Sun Alliance USA, was removed from the top twenty-five homeowners insurer list. There was also one group changing its name from Travelers Property Casualty Corporation Group to St. Paul Travelers Group.

The insurers' percentage increases among the top twenty-five homeowners insurers by voluntary market share ranges from +1.1% to +9.7%. Some of the insurers that had the largest voluntary market share increases were St. Paul Travelers Group, Commerce Group, Inc., Amica Mutual Group and Vermont Mutual Group at +0.9%, +0.6%, +0.3% and +0.3% respectively. White Mountains Group, Hingham Mutual Group, Plymouth Rock Insurance Group and Harleysville Group showed the greatest voluntary market share decreases at -0.7%, -0.4%, -0.2% and -0.2% respectively.

Also, this year's report includes an exhibit that shows insurer initiated urban and coastal non-renewals as a percentage of urban and coastal policies in force (see Exhibit 24). This is one more way to make comparisons between insurers.

It is shown in Exhibit 24 that the insurers that have the lowest percentage of insurer initiated non-renewals of urban & coastal policies in force are CNA Insurance Group (0.00%), Arbella Insurance Group (0.06%) and Harleysville Group (0.26%). The insurers that are highest are Andover Group (38.50%), which non-renewed its Barnstable County and other coastal business, White Mountains Group (12.94%) and Plymouth Rock Insurance Group (12.45%).

If an insurer's rates are higher than the FAIR Plan premium rates in a particular urban or coastal rating territory, then the insurer may not get business in that territory because its rates are not competitive with the FAIR Plan. A review of Exhibit 21 shows that rates for a number of the top ten insurers in urban areas are higher than those offered by the FAIR Plan. Thus, in those territories insurers' rates are a disincentive for a potential insured to select a voluntary policy of the same type that is offered by the FAIR Plan. If an insurer has no agents or production offices in urban or coastal areas, then it usually would have few policies in the same areas.

By all reports, internet sales remain well behind independent agents and production offices in generating business. Internet sales have had little impact in the Massachusetts homeowners market that does not have participation from the top three or four countrywide personal lines direct marketers. If an insurer markets to a specific market segment or niche and that market segment or niche is not present in urban or coastal areas, then that insurer may have little or no writings in those areas. Insurers' contracts with their agents and brokers often provide for additional compensation for business that produces desirable loss levels. In addition, some contracts require certain levels of production in order for certain products to be made available for sale. All of the above must be factored into consideration when analyzing why insurers write business in certain areas and not in others.

**Premium & Loss Experience by Designated Zip Code**

Again this year, Chapter 175, § 4A required statistical agents for Massachusetts homeowners insurance to submit premium and loss experience by designated zip code for the top twenty-five Massachusetts homeowners insurers by written premium and the MPIUA. The statute explicitly categorizes the individual insurer data as confidential and not to be made public except under well defined conditions. The Division has produced a 2004 aggregate premium and loss experience report for the top twenty-five insurers and the MPIUA for the designated zip codes in Appendix C.

Care should be exercised in drawing conclusions from one year's loss experience for a particular zip code. The data for most individual zip codes may not be 100% statistically credible. This means that one can expect significant random variation in the individual zip code loss experience from year to year. For example, the loss ratio for a particular zip code could be a favorable 25% in one year and an unfavorable 175% the next year. Additionally, calendar year 2004, as previously discussed, is generally considered to have

been a good year for Massachusetts homeowners insurance experience. Focusing on the individual year experience from a good or bad year will not provide correct inferences regarding the underlying loss potential for an individual zip code. That being said, the overall total market loss ratio experience for the designated zip codes is 54.8%**.** This loss ratio result is approximately 3.7% higher than the 2003 loss ratio result of 58.5% for similar zip code areas. The 54.8% is considered to be a good underwriting result.

**Cape Cod and Hurricanes**

Among the challenges that carriers and policyholders are facing, the Cape Cod and Islands area (composed of Barnstable, Dukes and Nantucket Counties) has needed to face a market with more expensive and reduced options for homeowners coverage. With the wealth of statistical experience that was derived from damage associated with Hurricane Andrew that struck south Florida in the early 1990s, experts have developed better and more sophisticated hurricane models that predict the probable maximum loss that would occur in the event of a catastrophic hurricane striking land. With the availability of more accurate topographic information and experience from recent hurricanes in Florida in 2004, the models are predicting greater potential losses across the eastern seaboard.

The Cape Cod and Islands area is situated in a vulnerable position geographically. Although most hurricanes do strike in the Caribbean and Southeastern United States, if a hurricane does proceed beyond Cape Hatteras in North Carolina, and does strike land, based on historical records, it is much more likely to strike New England than the Mid-Atlantic States. There is also the likelihood that if it does strike the Cape Cod and Islands area the storm will stall off coast, as do many winter Northeasters, prolonging the incident and causing more catastrophic damage. In addition, the development of expensive homes along the shore in the Cape Cod and Islands area, the presence of many trees in that area rooted in relatively sandy soil, and the difficulty in transporting materials to repair damaged property, possible losses in the Cape Cod and Islands area could be tremendous in the instance of a category 4 or 5 hurricane.

Despite the possibility of enormous losses, many residents are unaware of the real risk of such a storm. While forecasters predict that locales such as Florida should prepare for a category 4 or 5 storm at least once per decade, they predict, based on historical patterns, that Massachusetts may see such a storm only once per century. While many seniors recall the fury of the Hurricane of 1938 and the destruction in eastern New England, it is a faded memory for most New Englanders. Many cities and towns have therefore not taken the precautions that could reduce their exposure to the so-called “storm of the century”. It is in this environment, in spite of recent newsworthy losses in New Orleans and Port Arthur, Louisiana from Hurricanes Katrina and Rita, that many residents of the Cape Cod and Islands area are unaware of the potential risk of hurricane damage.

Although policyholders may not fully understand their exposure, homeowners insurance companies have been forced to recognize these risks, because the advent of the new hurricane models have predicted substantially greater potential costs in the Cape Cod and the Island areas than formerly contemplated. In order to reduce their potential exposures, these homeowners insurance companies need to purchase reinsurance from private reinsurers. They have found that they need to buy more and more expensive reinsurance

in order to maintain their financial strength ratings. Naturally, insurance companies can pass their increased costs along to their policyholders or decide to reduce the number of covered exposures.

During early 2004, one carrier announced that it would non-renew approximately 14,000 Cape Cod homeowners policies citing concerns about increased hurricane exposure in coastal areas. Since there are no state laws that require homeowners carriers to offer coverage or to continue to cover properties ever insured them, this carrier was required to satisfy only the advance notification standards in Massachusetts law put there to help policyholders to secure other coverage. As a short-term solution, most of the non-renewed policyholders found replacement coverage from the Massachusetts Property Insurance Underwriting Association, also known as the MPIUA or the FAIR Plan.

In Massachusetts, the FAIR Plan is considered the insurer of last resort, since it will cover all properties that are not picked up by other homeowners carriers. Coverage available through the FAIR plan is on par with what is available in the voluntary market and the rates charged by the FAIR Plan have been statutorily constrained with the result that they are competitive with the voluntary market. Within the past year, mostly due to the policy non-renewals along with its competitive coverage and rates, the FAIR Plan has doubled its Cape Cod and Islands exposures. Although this increase in FAIR Plan writings would seem not to affect policyholders, it does concern homeowners insurance companies that make up the Association. And, if the FAIR Plan has a fiscal year underwriting loss, all other homeowners carriers are assessed for the FAIR Plan losses; the potential for these assessments that will be ultimately passed along to their insureds in the form of rate increases.

Coupled with the reduced availability of non-FAIR Plan homeowners coverage in the Cape Cod and the Islands area, there has been the effect on rates of increased reinsurance costs on those persons who have been able to keep coverage from private insurers.

In light of the issues facing the homeowners market and the reinsurance market, the Division coordinated meetings in 2004 and 2005 with members of the Legislature and groups representing Cape Cod and Islands area agents and insurers regarding the declining availability of homeowner coverage. While all agreed that the FAIR Plan did present a viable short-term solution, there was concern about the long-term effects of relying on the FAIR Plan, given the possibility of a major storm striking the Cape Cod and Islands area and the ensuing assessments across the homeowners insurance market.

For these meetings, Division of Insurance representatives gathered advice from the FAIR Plan and Wind Pools that had been established by states along the eastern seaboard. What became apparent was that the Massachusetts' FAIR Plan was substantially more generous than similar plans found in other states and that the cause of the instability of the market here was the lack of stable sources of affordable reinsurance. From this research, the Division of Insurance began to consider the experience of the Florida Hurricane Catastrophe Reinsurance Fund, which was specifically designed to have a quasi-public source of reinsurance to stabilize the availability and the affordability of catastrophe reinsurance coverage. The Florida example was especially attractive, since it

was formed in a manner so that it was deemed to be not subject to federal taxation, further reducing the cost of reinsurance.

Following the original research, the Massachusetts Division of Insurance recognized that the state of Massachusetts may not have sufficient premium dollars to appropriately finance the workings of such a hurricane reinsurance pooling mechanism. Division staff then entered into conversations with staff from each of the Commissioner's Offices in the Northeast Zone, (composed of the District of Columbia, Maryland, Pennsylvania, Delaware, New York, Connecticut, Rhode Island, Massachusetts, Vermont, New Hampshire and Maine), to explore the feasibility of establishing a regional catastrophe fund. Although, it is difficult to find a consensus across the states regarding both covered catastrophes and the administration and governance of any such mechanism, the bigger hurdle is that such a pool would require each participating state's Legislature to pass laws permitting its state to be a part of such a multi-state pool.

Recognizing the ongoing nature of the problem, the Massachusetts Legislature enacted Chapter 436 of the Acts of 2004 (An Act Relative to the Joint Underwriting Association) that requires that a special commission be convened, composed of legislative leaders, the Commissioner of Insurance, a representative of the MPIUA, a representative of the Massachusetts Association of Insurance Agents, a representative of the Center for Insurance Research, and a representative of the Massachusetts Public Interest Research Group, to examine the homeowner insurance market in certain standardized territories. The new law requires that the commission investigate the availability and affordability of property insurance; the relevant rate driving factors including, but not limited to, insurance fraud, types of loss costs and their frequency, the cost and availability of reinsurance; the use of storm damage prediction data; the creation and potential benefit of a state-run catastrophic reinsurance program; and the overall competitiveness of the homeowners market in certain territories.

To this end, the Division has worked and will work within the statutorily formed commission to review and address the issues facing the homeowners market, especially as it affects the Cape Cod and Islands area.